

STATE INVESTMENT COMMISSION MINUTES

September 26, 2001

The State Investment Commission meeting was called to order by T. Kevin Flanery, Secretary, Finance and Administration Cabinet on September 26, 2001 at 1:30 p.m. in Room 264 of the Capitol Annex. Other members present were Orson Oliver, Bank of Louisville and Dan Logsdon, proxy for Jonathan Miller, State Treasurer.

Secretary Flanery confirmed that a quorum was present and that the press had been notified of the meeting. A motion was made by Mr. Oliver and seconded by Mr. Logsdon to approve the minutes of the June 25, 2001 meeting. **MOTION CARRIED.**

Gordon L. Mullis, Executive Director, Office of Financial Management ("OFM"), provided a brief economic update for the Commission members. Mr. Mullis directed the Commission's attention to the ***Kentucky Economic Indicators*** which is put together by Greg Harkenrider in the Office of the State Budget Director. Mr. Mullis indicated that Mr. Harkenrider states in this publication that the leading indicators have fallen for five consecutive months. Mr. Mullis further indicated that historically three consecutive months of downturn is an indication that the economy is in a recession. Mr. Mullis stated that total non-agriculture employment is down on a seasonally adjusted annual rate as of June. Personal Income is up at 3.5 percent, but the Kentucky economy would have to perform at closer to 5 percent to be performing well. On the national level, industrial production in the U.S. has declined for the ninth consecutive month. The consumer confidence index was recently released and indicated that consumer confidence fell 16 points from August to September. Mr. Mullis pointed out that 85 percent of the survey was done prior to September 11, 2001 and projected that the next consumer confidence index will be lower. Consumers appear to be concerned about the rising unemployment rate, the unsettled stock markets and a general feeling of uncertainty about what lies ahead for the United States. Mr. Mullis stated that according to ***The Wall Street Journal's*** survey of 26 economists, a reduction in the GDP of .6 percent for the third and fourth quarters of CY01 is expected. A sustained recovery is projected in the first part of CY03 and it will be well into FY03 before Kentucky's economy begins to feel any effects of the dip in the economy. Mr. Mullis further stated that durable goods will be down as housing construction slows and consumers become unwilling to take on additional debt. The transportation sector will be affected as the airline industry projects up to 100,000 total jobs lost this year. Kentucky is a huge manufacturer and supplier of automobiles and automobile parts. Automobile sales are down and inventory is up which means additional layoffs are anticipated. Federal Corporation Tax receipts for the preceding 11-month period are down 12 percent from last year. Since March, Kentucky's economy has lost 23,000 jobs and it is estimated that the total jobs lost may reach 1,000,000 before the economy begins to recover.

Secretary Flanery asked Dwight Price, portfolio manager, Office of Financial Management, to present an update on the Commonwealth's portfolio to the Commission members. Mr. Price informed the Commission members that included in the agenda are the charts from the bond proceeds, long-term and intermediate pools showing the annualized yield and the difference for the pools. Mr. Price pointed out that through August the portfolio is still tracking closely with the Index in spite of market volatility. Mr. Price presented to the Commission members a summary of Credit Suisse First Boston's performance as an agent basis for the securities lending

program. The summary indicates the portfolio has made more money to date than what would have been made previously for the entire year. Credit Suisse guaranteed earnings to the Commonwealth of 14 basis points which has brought the total earnings to \$1,385,619.36. Mr. Price is confident that changing from a principal basis to an agent basis was a good decision. The program will be re-evaluated next year as interest rates begin to rise. Mr. Mullis pointed out that none of the funds generated by this program would go to the General Fund to decrease the shortfall.

Secretary Flanery noted that the Consensus Forecast Group ("CFG") is scheduled to meet on Monday, October 1 to forecast revenues for the next budget cycle. Secretary Flanery projects that by October 15 the group will revise the forecast for the FY02 budget. The CFG projected a revenue shortfall of \$285 million and with other budget issues, the total revenue shortfall is \$326 million. In addition, the SCOPE forecast projected an additional \$60 million shortfall which will bring the total to \$386 million.

Mr. Mullis informed the Commission that Mr. Price will be reviewing benchmarks over the next several months and Commission members will have an opportunity to review findings at the next meeting. Mr. Mullis also stated that staff has not been pleased with the performance of the Bank of New York with regard to the Commonwealth's custodial contract and is in the process of asking the lead bank to bid the custodial contract. Both of these items will be presented to the Commission for their approval as decisions are made regarding them.

With no further business before the Commission, the meeting was adjourned at 2:15 p.m.

Gordon L. Mullis, Secretary
State Investment Commission